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# An economic puzzle

Jun 29th 2007
From Economist.com

### The conundrum of America's economy

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THOSE who keep a close eye on the state of America's economy might be forgiven for being puzzled: there are reasons aplenty to feel both gloom and cheer. On Thursday June 28th revised first-quarter GDP figures showed that the economy has not been growing all that briskly (it expanded at an annualised pace of just 0.7%). A report from the Federal Reserve noted that price increases have been moderating of late. Despite this, its main concern remains inflation, rather than stimulating the economy.

There are plenty of ominous signs. The housing market, long the mainstay of America's economic boom, is sagging. Defaults in the subprime lending market grow ever more worrisome. The core inflation rate, which excludes food and energy, is not exactly subdued: consumer prices were up by 2.2% in May from a year ago. Add in the tepid GDP growth and the mix is making consumers nervous.

But the gloom does not penetrate everywhere. The jobs market, where one usually looks for signs of a flagging economy, looks healthy. The unemployment rate is 4.5%, down from last year, and lower than in all but the rosiest days of the Clinton era.

This apparent strength has revived controversy over the discrepancy between the two main sets of employment figures: the payroll survey and household data. The former monitors employers, asking them how many jobs they have created or destroyed over the past month. The household survey asks people directly whether they are employed. Since the 2001 recession, these figures have diverged.

When the payroll figure was significantly lower than the household number, critics of George Bush's administration gleefully proclaimed that it was the "correct" measure. Mr Bush's defenders, on the other hand, pointed out that the payroll number left out the self-employed and small businesses that are too tiny to be surveyed.

Most analysts, however, continued to rely more heavily on the payroll numbers, which use a much larger sample size of about a third of American businesses. The divergence is still there, but strangely is now reversed. The household figures show total employment unchanged in May, at 145.9m. But the payroll survey indicates that the economy added over 150,000 jobs from April to May.

More mysterious still are housing-related jobs. Over the past few years a buoyant housing sector has contributed enormously to the economy; its current slowness is casting a pall. Consumers can no longer tap the piggy bank of their home equity to keep spending and property-development profits have vanished. The government estimates that the housing slump lopped nearly a percentage point off GDP in the first quarter of 2007.

If so, that ought to mean fewer construction jobs, as developments dry up. Yet, on a seasonally adjusted basis, fewer than 50,000 construction jobs have gone since the beginning of the year, less than 1% of the industry's total. Given the devastation in the housing sector, and the transient nature of most construction jobs, this is surprising.

Could it be that the payroll survey simply missed a lot of construction jobs, as it misses small businesses, and that job losses in the construction industry are concentrated among the smaller fry? That seems unlikely. The payroll survey showed an enormous increase in construction employment during the housing bubble; the number of workers in the industry has swelled by just over 800,000 since 2004. One would expect to see many of those people laid off as the housing bubble collapses, but so far it hasn't happened. That may mean there is something wrong with the data, or perhaps the housing market is less parlous than it seems.

As vexing a concern is the effect that a slowing housing market will have on the mountain of debt and debt-related instruments that were issued to finance the boom. The most frightening aspect of the problems at two hedge funds run by Bear Stearns, both heavily exposed to the subprime-mortgage market, was not that a big bank had been plunging into risky assets; it was the revelation of how little anyone knew about the risks involved. The market was so leveraged, and the instruments so complicated, that no one seemed understand what would happen if it all began to unwind.